China Real Estate Market - 2022

SPOTLIGHT
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Balancing Act

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Foreword

2020 was a challenging year for the public and the economy, 2021 has been a challenging year for the property market, what will 2022 hold?

The first half is likely to prove challenging as debt repayment events continue to arise and credit markets are likely to remain tight despite some loosening at the edges in the last months of 2021. Nevertheless, as authorities provide greater clarity as to how credit default and bankruptcy events are likely to be dealt with and as the government makes effort to ensure creditworthy developers can access credit markets, a better common understanding will be reached and with that a base from which to grow from.

Residential sales markets will see performance vary significantly by market. Lower tier-cities, dominated by first-hand sales and driven by price growth expectations, are likely to struggle in 2022 and will have to be supported by policy measures. The more mature higher-tier cities on the other hand will likely see lower volumes by stable pricing as a strong end user base provides support and some particularly restrictive policies are relaxed. The multifamily market on the other hand will be buoyed by continued growth in demand as potential home buyers remain on the side-lines of the sales market, and as institutional capital continues to seep into the market, improving the range and quality of offerings.

The commercial markets remain up in the air. 2021 has been a fabulous year for the office market with a strong economic rebound boosting occupier demand, nevertheless, financial pressures and regulatory risks along with other economic headwinds continue to weigh on 2022's outlook. The retail market has also seen a strong rebound in 2021 led by luxury sales and "Guochao" brands, though concerns of real estate values (a proxy for net wealth), weaker economic prospects, and sporadic covid lockdowns continue to hinder consumer markets.

The industrial markets are expected to remain the bright spot with new capital sources (developer, REIT, funds, etc.) pouring capital into greenfield developments, conversions and stabilized assets, developing a new pipeline of assets, and pushing up prices. Meanwhile, government support measures, domestic R&D, centres of excellence, tax subsidies, as well as structural fundamentals continue to drive new demand from tenants in the logistics (dry, chiller, and refrigerated), IDCs, and life science sectors.

Investment markets could have a bumper year next year when it comes to transaction volumes as there may be more asset and portfolio fire sales, bailouts and M&A activity, or state-led asset restructuring, as well as the processing of banks NPLs that are collateralised against real estate. There will also still be the opportunity to reposition assets into higher and better use cases. Repositioning/renovation of existing assets also has the potential to improve project sustainability while also reducing urban sprawl leaving more space to the public and greenery, something a lot of cities are promoting with a focus on city liveability, sponge cities, air quality, and other factors.

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Surviving a tightening credit market

Investors will continue to put relatively high-yielding niche assets into their investment portfolios

18%

of the first batch of REITs non-weighted share price growth

Debt and Developers

The availability and cost of financing is an incredible factor in the investment market and general health of the real estate market, determining what assets are acquired and when. In the past decade, China's real estate market has witnessed explosive growth which relied largely upon the comparatively cheap financing that domestic developers and investors had access to. Shanghai's en-bloc transaction volumes peaked at around RMB100 billion per annum between 2017 and 2019.

Largely unfettered access to debt and rapid expansion has straddled many developers with seemingly insurmountable debt piles that rely on the assumption that the capital value of the real estate will keep growing, as well as fragile cashflow positions that rely on the assumption that developers will be able to roll over debt and continue to sell properties. The current real estate debt crunch highlights the importance of more sustainable growth and managing debt risks especially when the overall economy looks set to slow. As the government's long-term objectives to reduce systemic financial risks remain unchanged, the credit markets are expected to remain tight in 2022 while refinancing and default risks will remain high for certain developers.

Financing

The governments' approach to debt in the real estate market has been three pronged: tightening developer financing with policy measures such as the "Three Red Lines", more stringent background checks on potential home buyers, and caps on bank's exposure to the real estate and mortgage markets. Banks have it particularly difficult as they try to work a balance between managing bad loans and default risks, turning a profit and supporting government efforts to shore up economic growth and improve market stability. Banks are therefore carrying out greater due diligence on borrowers, favouring mid- to large-sized, financially sound businesses with good credit. If the collateral for the loans is in leading cities and favoured asset classes like logistics, then all the better. While SOE developers are still favoured, they are no longer seen as being immune to potential default risks.

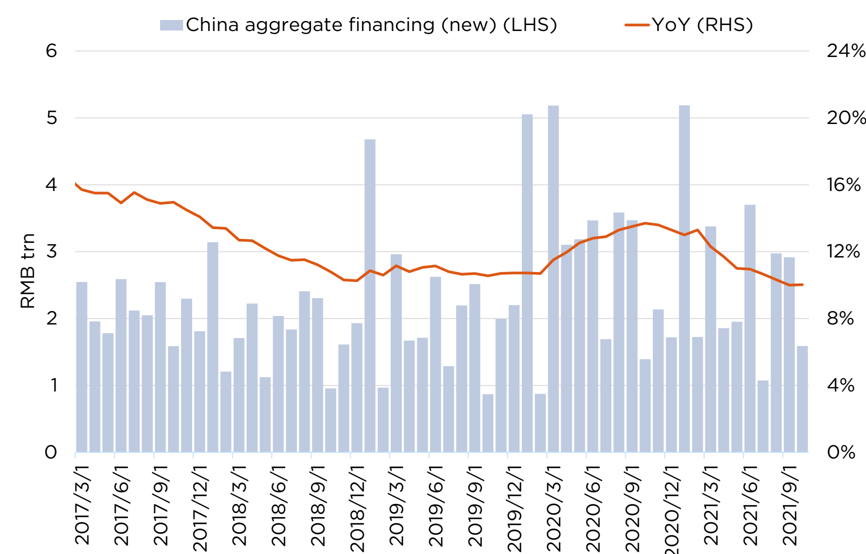
Investment Classes

China's commercial asset classes continue to run at a negative spread against borrowing costs, similar to developing countries at an earlier point in their growth phases, therefore, investment returns are still predominantly driven by the expectation of capital growth. Nevertheless, ample supply and potentially diminishing demand are unlikely to support the levels of rental growth required to justify the higher valuations. At the same time, access to and the cost of debt is unlikely to be comparable to previous years. As a consequence, many investors are seeking out higher yields assets from the niche markets which still have scope for further yield compression. Logistics has been the most highly sought-after sector for years, however, as competition intensifies and yields fall, other sectors are starting to get more attention, whether that be data centres, business/industrial parks, life science real estate, or for-leasing apartments. These sectors are also expected to benefit from structural demand drivers, support from the government, rising consumption level, and changing behaviours.

REITs

While financing may be eased at the fringes, there is unlikely to be a full reversal of policy direction and as such, investors and developers will have to look for a more sustainable and long-term financing channel. The launch of REITs, which is an important source of long-term investment capital in many markets around the world, therefore, seems to be very timely. The first batch of China Infrastructure REITs launched on Jun 21 have performed very well with an average unweighted price increase of around 18% by 1 December 2021. The potential scope of underlying assets is also expected to be expanded for coming issuances while preferential tax treatments should encourage more developers and investors to use REIT structures. While new equity sources may be able to offset some of the debt in the market, it is not possible to replace all financing with equity. For the remaining debt, the government continues to push for greater transparency in who has issued debt, who it is owned by, and how it is issued. At the same time, products such as green bonds are likely to become more common, promoting more sustainable development practices.

Figure 1: Aggregate increased financing



Source CEIC, Savills Research

Key trends

International investments return

International investors have not been particularly active in the Chinese real estate market compared to previous years, this is partly due to travel restrictions in response to COVID-19 which has made it difficult for overseas investors to carry out site inspections, participate in face-to-face negotiations, and make deals happen. At the same time, market fundamentals have softened while there has been no corresponding change in pricing unlike many other international markets. Nevertheless, as financing remains challenging in China, domestic funds could scale back their investments, thus presenting international investors with more investment opportunities. As developers look to restructure asset holdings to reduce gearing and shore up short term cash, discounted assets may become available as they have in the final months of 2021. While international investors have a lot of dry powder ready to deploy and are underweight on China given limited exposure in recent years, they are still likely to remain cautious when acquiring assets given continuing disruptions caused by zero covid policies, recent regulatory crackdowns of key industries, and slower economic growth resulting from the slowdown of the real estate industry.

Asset management becomes the key

Asset owners and managers have to spend more time and effort maintaining and improving the asset quality and operations if they want to achieve higher rents and attract tenants in what is becoming an increasingly competitive market. Improved efficiency could also boost margins and sustainability standards.

ESG is the hot topic at the moment though it is not fully understood by many. While all real estate practitioners must club together to affect meaningful change, it is really the asset managers that can truly have the biggest impact. ESG can take many forms, from staff training, and procedural changes, to the adoption of new technologies, and the upgrading of outdated facilities. No matter what, ESG has decidedly shifted from a “nice to have” to a “must-have”, with asset values and asset managers being benchmarked against these new metrics.

As developers continue to grow and accumulate more recurrent income-generating assets, more might conclude that it might be better to spin off the asset management component of the business, given the different nature of income streams and risk profiles, especially if firms continue to trade at such significant discounts to net asset values (NAVs). For example, CapitaLand recently announced plans to split its business into real estate investment management business, which will be listed as a new entity, and its property development business, which will be taken private. By doing so, CLIM can sharpen its focus and transition to an asset-light and capital-efficient business and deliver better results to the investors.

Digital driving demand

Network effects, fund raising, and government support continue to boost the growth of the wider industry

50%

China's digital market's contribution to the economy by 2025

The office market saw a strong recovery in demand in 2021 with Grade A office net take-up expected to double 2020's level in ten key cities. Demand was largely driven by tech, finance, and online services firms despite a tougher regulatory environment, potentially given the lag between policies and company decisions, or also as firms look to diversify business scope in order to be more resistant to future changes, and as company monopolies are broken up. As a key demand driver, tech companies have significantly increased their presence in key cities through new leases and purchases of headquarter spaces.

China has experienced a rapid digitalization of its economy over the last decade. The size of its digital economy accounted for 39% of GDP in 2020, up from just 20% in 2010. In recent years, the booming e-commerce sector and the sharing economy in China have become new engines for job creation, needing more office space to accommodate their expanded headcount.

While the digital sector continues to be dominated by domestic capital, foreign direct investment (FDI) continues to flow into China's tech industry, as the country looks to lead technological innovation in coming decades. Data from Pitchbook indicates that big data, AI, and fintech are the main sectors attracting venture capital. Accordingly, the Ministry of Commerce (MOC) reported that the actual FDI in China's high-tech industries increased 29.1% in the first nine months of 2021. Companies such as Temasek will continue to seek for investment opportunities and look at digital transformation as a key trend when investing in China's tech sector.

The government's continued investment in digital infrastructure over the past few years has supported the growth of the tech sector. To note, more than 20 provincial and municipal cities including Beijing, Tianjin, Shanghai, Sichuan, Chongqing, and Guangdong have released plans to enhance their digital infrastructure including the roll out of 5G networks. Meanwhile, the government also supports tech start-ups and SMEs by offering favourable incentives such as tax reduction/exemption, light regulation at the early stage of development, and reward to new patents to encourage innovation.

Table 1: China's leading tech clusters

City	Key tech cluster	Cluster type	Anchor tenants	Rental range (RMB psm pmth)
Beijing	Zhongguancun	Traditional	Lenovo, Google, ByteDance, Tencent, Intel	300-550
Wuhan	Optics Valley	Business park	Huawei, Xiaomi, iFLYTEK, ByteDance	50-120
Shanghai	Caohejing	Business park	Microsoft, Tencent, ByteDance, SenseTime	150-180
Shenzhen	High-tech Park	Business park	Kingdee, Tencent, ZTE	110-240
Chengdu	Dayuan	Traditional	ByteDance, Legou Games, IGG Games	90-110
Chongqing	Dashihua	Traditional	ByteDance, Alibaba, T3 Go, JD	55-70
Hangzhou	Future Sci-tech City	Traditional	ByteDance, Kuaishou, Didi, Alibaba, Ant Group	75-115
Guangzhou	Pazhou	Traditional	Alibaba, Tencent, Joyy, RootCloud	120-170

Source Savills Research

Demand blowout

Technology is developing at an unprecedented speed. Recently listed companies are aggressive in taking up office spaces for upgrade/expansion/consolidation or looking to establish regional or national headquarters. Moreover, they are also seizing the opportunity to acquire office developments.

Notable sales transactions in 2021 included Kuaishou purchasing 114,200 sq m office in Shangdi, Beijing (Q1/2021); ByteDance buying 195,000 sq m office in Yangpu, Shanghai (Q3/2021) and a 58,000 sq m buildable area commercial land in the same district (Q3/2021); and Ant Group acquiring 326,000 sq m commercial land in West Lake, Hangzhou (Q3/2021). However, the acquisitions of HQ space did not negate their supplementary leasing needs, with the above deals coming after Kuaishou and ByteDance's previous office expansions of 119,500 sq m and 42,000 sq m, respectively.

Considerations when selecting office premises

The tech sector covers a large gamut for firms with each having unique office requirements. While many firms take space in traditional office buildings, many still prefer tech clusters in business parks or creative office spaces especially those with favourable government incentives, signage rights, large talent pools, better liveability, affordability, and amenities. National HQs tend to be located in first-tier cities (Microsoft → Beijing) or home cities (iFLY TEK → Hefei) while provincial capitals and municipal cities are often chosen as regional HQs (Xiaomi's East-China HQ → Nanjing). At the same time, some larger firms may choose to locate their business departments or subsidiary HQs in cities based upon industry strength (Tencent Neo-Culture HQ → Chengdu). Domestic cash-rich companies are expanding aggressively often through acquisition, while foreign tech companies tend to lease.

Government support and intervention

Digitalization brings significant economic benefits but also its own unique set of challenges. Chinese authorities enhanced regulatory oversights of fintech, e-commerce, and other online service sectors to ensure market stability, break up monopolies, and enable smaller firms to compete with established players. Over the next five years (2021-2025), China plans to push forward with the implementation of additional data security regulations.

Regulatory oversight might impact individual companies but will unlikely reverse the continued growth of the sector as a whole. China's tech sector is expected to continue its rapid growth considering the country's large internet user base, well-established online ecosystem, improved digital infrastructure, and consumer-driven digitalization, thus providing new engine of economic growth. China's digital economy is forecasted to more than double to RMB80 trillion by 2025, accounting for half the country's economic output.

Key trends

Work from anywhere

While the rest of the world was thrown into lockdown over the last two years, effective epidemic control in China allowed the resumption of most day-to-day activities relatively swiftly. Nevertheless, there are still no insignificant changes to the way people work. The main reason for this is the acceleration of technological changes that enabled or improved the way that people can work and collaborate. Hot desking was all the rage a few years back but often, the execution fell short of what was previously envisioned. Even so, technological and social changes over the last two years could mean getting closer to the ideal.

This could gradually have a more meaningful impact on the way people work and the spaces required by companies. There could be more collaborative locations and less fixed workstations, more hybrid work models, and flexible hours requiring offices to be open for longer but not at full capacity.

Downtown HQ buildings

Smaller office blocks (10,000-15,000 sq m) are popular with tenants seeking private entrances, signage rights, and smaller lump sum purchases. New developments are increasingly comprised of a mixture of high-rise towers plus smaller HQ blocks to diversify offerings and meet this demand. This type of products is increasingly welcomed by companies looking for standalone towers but are reluctant to stay away from central locations.

Multi centric business landscapes

As city office markets continue to grow and as authorities look to release pressure on strained infrastructure and share the economic wealth of the country's megalopolises, planning authorities continue to add new business districts to cities landscapes.

While this invigorates office markets, it also brings competition. To ensure a long-term healthy business environment, the best solution is to differentiate industry clusters. This is also a way to make more efficient use of land and optimize the allocation of resources.

While this trend has been present in the past, it will likely continue and accelerate in the next 5-10 years. Areas such as HTH core (Shanghai), Lize (Beijing), and Qianhai (Shenzhen) are not new for the China office market but Hongqiao Qianwan (30 million sq m development on 30 sq km land, Shanghai), "Five New Cities" (Shanghai), Qianhai expansion (120 sq km, Shenzhen), and Guangdong-Macao In-Depth Cooperation Zone in Hengqin (106 sq km, Zhuhai) will write the future.

Over the peak, not over the hill

Long-term capital has become the key source of retail market from development to en-bloc transactions

10%

Average stock increase in key cities

Annual supply in Shanghai peaked at 1.4 million sqm in 2021. Other cities, such as Chengdu and Tianjin, recorded peak supply in 2017. The retail stock increased on average by 10% in 2021 in the country's 15 more important retail cities, but this rate of expansion will slow to single digits in 2022.

Consolidation

As the pace of new completions continues to slow so the pace of market consolidation will accelerate. With land auctions in core locations, local governments will look to attract leading developers to create new retail landmarks, setting higher requirements for bidders of prime land plots. Such requirements include both domestic and international developer experience and reputation, retained ownership, the construction of public facilities, and even the specification of future tenant categories. In Shanghai, a land plot along Huaihai Road (M) recently acquired by Hong Kong New World required the developer to hold the entire project (office and retail) for the duration of the land tenure, for the developer to have a strategic partnership with overseas art institutions, and to hold at least six art exhibitions a year. In Hangzhou, SKP acquired a land plot in Qianjiang Century City, which required the developer to retain more than 55% of the development, including a 170,000 sq m shopping mall. The more onerous the requirements are, the more limited the field of potential bidders, with only the leading developers with strong financial backgrounds and track records and long-term vision are able to compete.

Long-term Capital

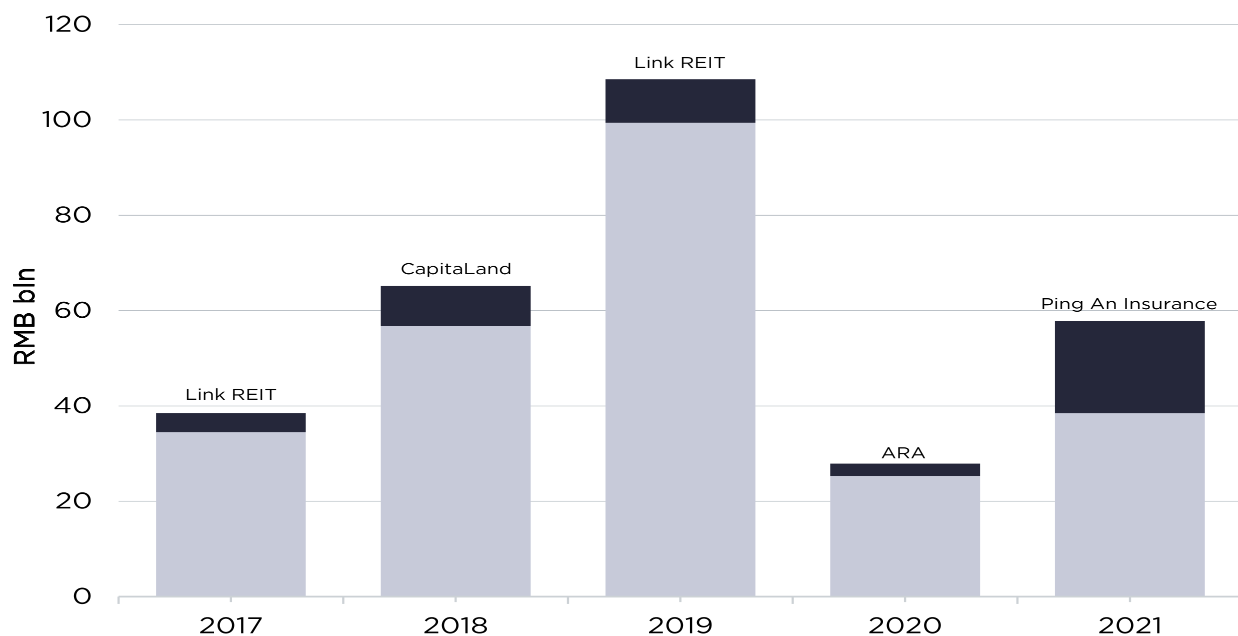
Financing conditions are likely to remain tight for the real estate industry in 2022 despite excluding the possibility of some policy tweaks at the margins. Larger institutions with healthy balance sheets are likely to be the beneficiaries, shifting their focus to projects that offer stable and sustainable cash flows. Leading retail assets remain attractive in this sense having proved resilient over the last two years while also benefitting from the increasingly consumer-driven economy.

Thanks in large part to two portfolio deals, long-term capital dominated the retail en-bloc investment market in 2021 which helped to more than double investment volumes to RMB57.8 billion. The top three buyers accounted for 60% of the total value, a record high in the past five years. Ping An Insurance and Brookfield each bought a portfolio of retail assets while Link REIT inject several projects into its Hong Kong listed REIT. With the continued growth of the luxury sector, flourishing of domestic brands and government emphasis on dual circulation and domestic consumption seemingly unchanged, this trend is expected to continue into 2022.

Retail Conversions

While large players are expected to dominate the development market, small scale projects in need of repositioning and refurbishment can still provide opportunities for smaller funds and asset management firms. Projects could include almost anything from wet markets to old factories, or the plain vanilla retail podiums. There are of course challenges in terms of obtaining the correct permits and accessing the right opportunities. Nevertheless, these are both becoming easier as local governments look to accelerate urban rejuvenation while maintaining a city's urban fabric. On the other hand, SOEs or local landlords are encouraged to enhance asset portfolios. Successful upgrading improves the environment of the community and brings new employment opportunities and tax revenues.

Figure 2: En-bloc retail transaction value



Source RCA, Savills Research

Investor strategies

	Larger developers	SME developers	Core funds	Opportunistic funds
Challenge	Complicated portfolios often spread over a wide geography with a range of asset types	Lack of landmark project or strong branding	Difficulty in securing and retaining strong asset management teams	Difficulty in repositioning, launching, and stabilizing an asset in short time frame
Financing	Varies based on corporate background	Significantly tighter financing constraints	Strong financing capabilities	Significantly tighter financing constraints
Product	In keeping with overall brand imag	Set up business model, build up brand reputation	Build up brands backed by professional AM	Niche, smaller scale
Strategy	Development of IP and strong branding Retailer relationships Asset held long term and self-managed	Individual assets Supporting amenities for residential or mixed-use projects	A small portfolio of assets Dedicated asset management team (in-house or outsourced)	Mostly single assets Focus on reducing costs and maximizing operational efficiency Clear entry and exit routes and timeline

Intelligent levelling up

Intelligent logistics with sustainability at its core is vital to meet future targets as the market grows rapidly

15%

CAGR of cold chain market growth by revenue, 2015-2020

Technology fuelling the market

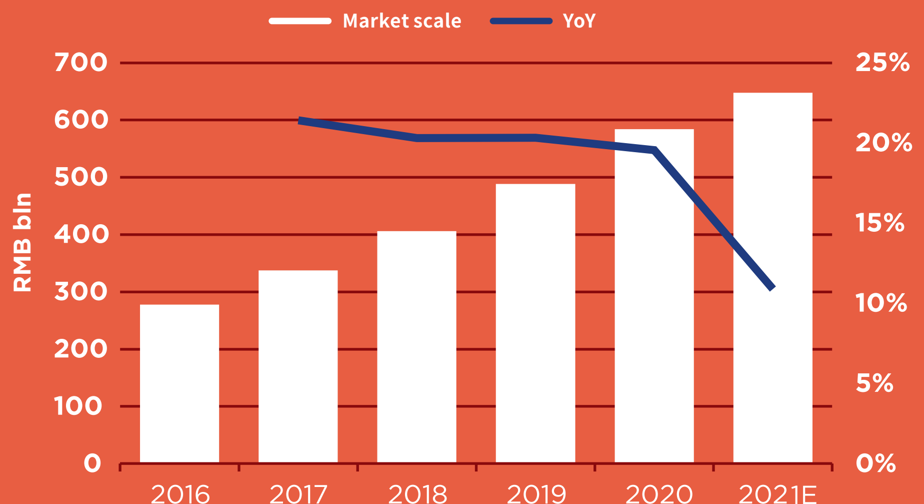
The rapid growth of e-commerce, 3PLs, and intelligent manufacturing demands higher operational efficiency, accuracy, and intelligence throughout the supply chain. To meet tenants' demand for efficiency and thereby improve operation management, logistics real estate is in great need of tried and tested, practical technology as one of its most important components. Automated multi storey warehousing, for example, increases storage capacity by 5-10 times compared to the ordinary modern warehouse. Meanwhile, automatic sorting systems, AGV robots, and cloud system applications all help improve warehouse intelligence, safety, and efficiency.

Refrigerated warehouses, compared to dry warehouses, are more energy intensive and rely heavily on technology. Simple technologies such as Radio Frequency Identification (RFID) tags can greatly improve labour productivity and reduce errors and are expected to be more widely adopted in the future to better serve tenants and improve warehouse efficiency. These technologies will also improve the energy-savings as China maps its path to carbon peak and neutrality. While the current cold chain market in China is relatively small and fragmented, it is growing rapidly, driven by demand fresh food groceries and the pharmaceutical industries. Revenues in the industry grew at an estimated 15.0% CAGR from 2015 to 2020, according to LeadLeo and is expected to grow to RMB466 billion by the end of 2025. Investment and M&A activity in cold chain storage sector also picked up as investors look to increase exposure to the next big thing, and as developers look to monetise assets so they can quickly redeploy before the window of opportunity closes.

JD.com's deployment of JD Asia No. 1 warehouses (fully automated warehouse) across China and upgrading of traditional space into automated warehouses by tenants themselves highlights the importance being placed on technology in logistics real estate. Nevertheless, upgrading existing projects is by no means an easy task. It can require significant investment and overcoming obstacles such as the cost-effectiveness of deploying systems into smaller projects. In addition to the practical challenges of deploying technological solutions, is the difficulty in convincing current owners of the value and necessity of upgrading facilities especially during the current growth cycle, while also having to retrain staff so that they know how to use the new systems.

In the long run, the decline of China's working-age population, rising land prices, technological advances, and the need to monitor various systems and promote sustainability, will make adopting more technology in the logistics industry increasingly important. This will help the industry to continuously deepen its development in terms of cost reduction and increase efficiency. Logistics digitalisation and intelligence will also help accelerate the development of the industry.

Figure 3: Intelligence logistics market scale



Source ASKCI, Savills Research

Key trends

Green and sustainable development

As early as 2018, GLP and Brookfield had each invested 50% to establish a joint venture and promised to deploy C&I rooftop solar arrays that could generate 300 MW on the roofs of GLP's logistics and industrial projects in China over a three year period, which will eventually be extended to 1 GW in the future, equivalent to the annual power consumption of 750,000 households.

Corporate tenants are paying more attention to environmental and social responsibility especially given wider adoption of ESG reporting for listed firms. While some real estate owners might only aim for the minimum sustainability standards required by regulations, others are going much further. The hope is that by adopting these standards now they can ensure that they remain ahead of new regulations and avoid costly retrofits. At the same time they can use their green credentials as a point of differentiation to attract tenants that, in addition to Scope 1 & 2 emissions, may also start tracking scope 3 emissions, thereby increasing occupancy rates and possibly rents while also reducing running costs and reliance on grid electricity, especially important during recent power outages.

New players emerge

With opportunities in traditional commercial real estate sectors declining, more and more firms are looking to get into the logistics sector. CapitaLand China Trust was one of the latest to adopt this approach acquiring four high-quality warehouse assets in Shanghai, Kunshan, Wuhan, and Chengdu for RMB1.7 billion in the final quarter of 2021, looking to increase its exposure to the new economy sector. Internet/e-commerce companies, such as ByteDance, are also investing in upstream and downstream industries such as warehousing service, cross-border ecommerce platform, and automatic guided vehicle (AGV) companies as their e-commerce businesses continue to expand. As the market continues to mature and leading developers consolidate their market position it will become increasingly challenging for new firms to enter the market through the new project development with the alternative being to acquire assets, portfolios, or platforms from existing players.

New era requires a new approach

Slow start to the year with policy support/clarity taking some time to feed through to market conditions. The second half of the year is expected to be more stable

6%

the percent of 33 leading developers expected to record sales declines in 2021

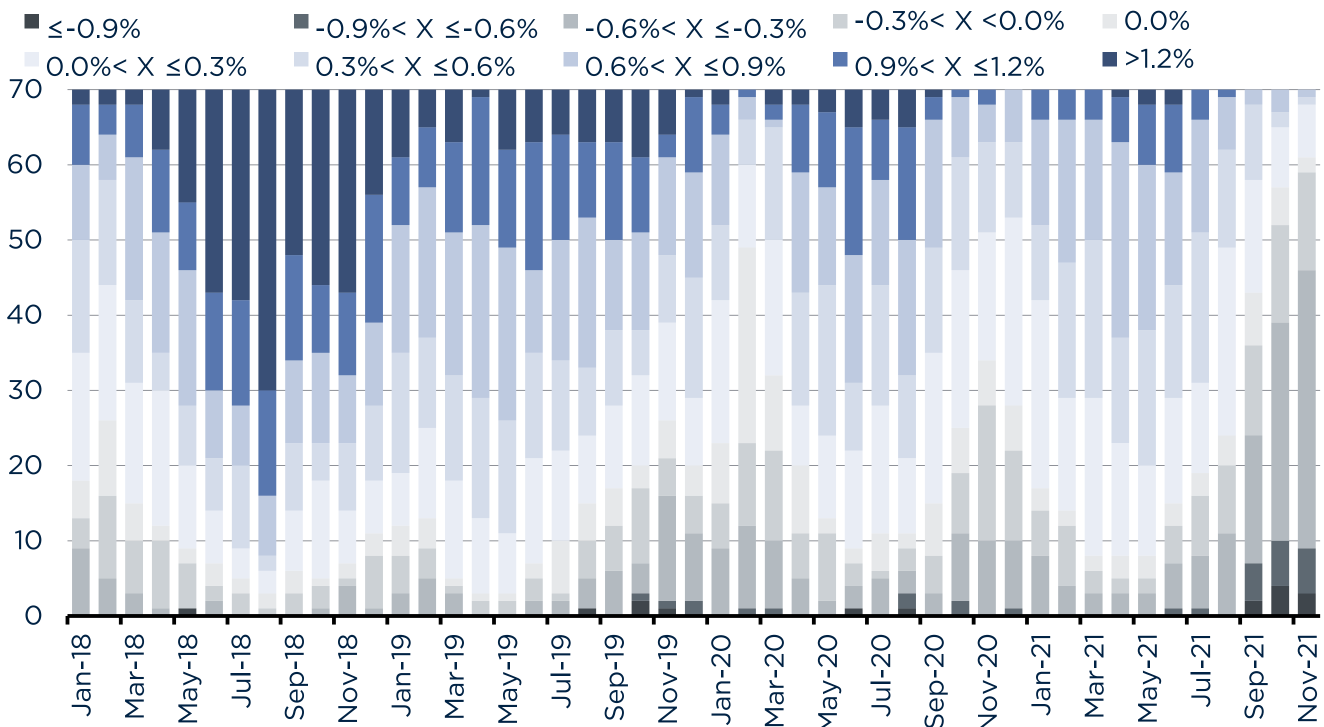
Review

Aside from some slight relaxation in the first half of 2020, the most recent round of policy tightening targeting developer financing and the residential market really started back in 2019. Different cities adopted different policies depending upon their local market conditions but generally speaking, there was a focus on controlling purchases, sales, and mortgages. In contrast to previous cycles, the central government has largely stayed the course with the most recent policy drive keeping up the pressure on the market throughout 2021. First-hand transaction volumes in H2/2021 fell 35% compared to a year earlier, admittedly a high base of comparison, bringing the first eleven-month transaction volumes to 1.4 billion sq m. Sales were impacted by prolonged mortgage application periods, stricter purchase requirements, and deteriorating confidence leading to a wait and see sentiment.

Outlook

The policy environment is unlikely to tighten further in 2022 with local policies having a degree of flexibility enabling authorities to adapt to the situation on the ground while not undermining national policy directions. In the land market, 30% of land auctions in the second batch failed to attract bidders or were cancelled before they went to auction, several local governments then adjusted requirements or lowered reserve prices in the third batch. In the financial sector, housing related loans increased slightly towards the end of 2021. The current strong wait-and-see attitude and lag between policy introduction and market impact will mean it will likely take another six months before we see greater stability and clarity in the residential market. Some let up in the financing situation for leading developers will help improve liquidity and stop healthier developers from experiencing liquidity crisis, nevertheless, the overall real estate policy environment will remain tight.

Figure 4: 70 Cities MoM First-Hand Residential Price Movements



Source CEIC, Savills Research

New policies

The property market is going through a transition period and policies and tax regimes will have to adapt to these changes. Many sectors, not only the real estate sector, are seeing new regulations being introduced to encourage healthier business practices and development trajectories. For instance, the property tax allows local governments to create alternative revenue streams and offset the potential losses from a slowdown in land sales. In addition, the tax would increase the carrying cost of residential for individual owners, encouraging more equitable ownership and more efficient utilization of the existing residential stock.

Based on discussions and the experience from the pilot program implemented in Shanghai and Chongqing, the property tax is more likely to have a low tax base and tax deductions for certain groups of people. Depending on the impact of the property tax on the market, other policy measures could be adjusted. If the impact of the property tax is significant, the removal of short-term policies such as house purchase requirements is possible, on the other hand, if the impact is minimal, other policy measures are likely to remain in place for the time being.

Key trends

Rental housing market

Rental housing became a key policy tool to address the supply side constraints affecting the residential sales market back in 2016 and over the last five years has gained a much clearer market positioning, while leading owners and operators have emerged. Since the first batch of for lease residential land sold in 2017, governments at all levels have put forward continuous policy support measures for the leasing sector. While the sales market remains under strong policy control, the leasing sector, on the contrary, is receiving favourable fiscal and tax support with central and local governments continuing to promote the future development of the rental market.

Rental housing offers affordable choices for young professionals, especially in cities with large migrant populations. While the product itself helps address the increasing housing demand, the sales market remains strong for key cities like Guangzhou, Hangzhou, and Chengdu. Cities recording slower population growth like Tianjin, however, have been more impacted by the introduction of rental housing.

SOEs dominant land sales

In the land market, local governments are becoming explicit about what they want to achieve from land sales, designing specific auction requirements to get the most from their increasingly limited land resources. Private developers are facing financing constraints making it harder for them to make new land acquisitions. Meanwhile, SOEs and local urban investment, which tend to have better access to financing, have dominated the second and third batch of land sales being more willing to accept profit margin caps and support local authorities land sales revenues. This trend is expected to continue into 2022. Small and medium-sized developers on the other hand will have to compete for smaller scale development opportunities in key cities which are likely to be overlooked by SOEs.

Diversified demand, uplift supply

Investors are increasingly interested in the entry-level serviced apartment and premium multifamily sector with its differentiation with the more competitive mass market sector

5.4%

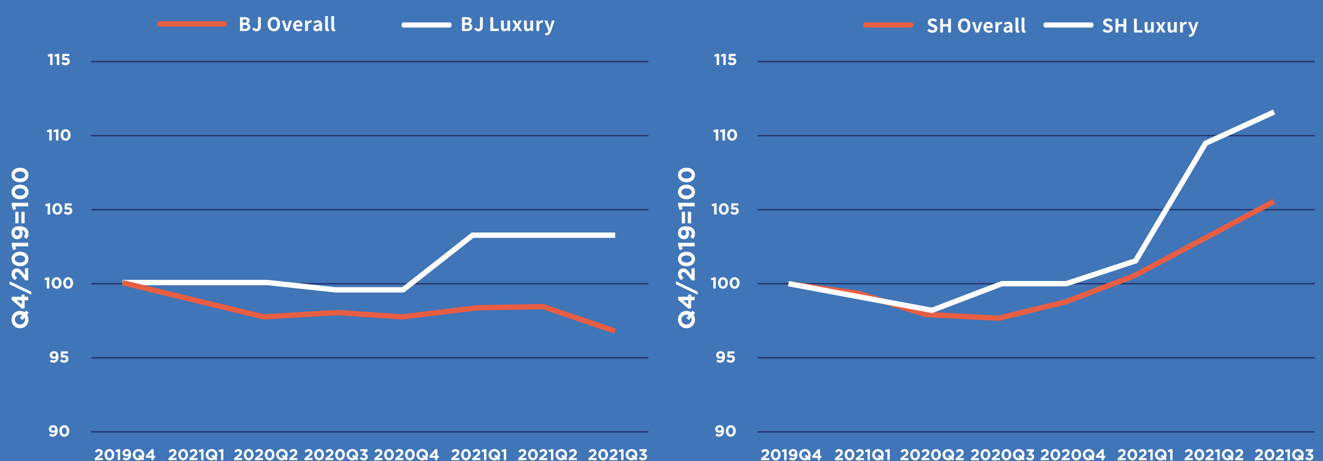
Average rental growth of luxury serviced apartment in Shanghai and Beijing in 2021

COVID-19 has accelerated profound changes to the tenant structure of high-end serviced apartments which continues to shift towards an increasingly domestic client base. Due to strict border entry policies and quarantine measures, the number of overseas clients among new tenants has sharply decreased. Domestic demand, however, has seen a steady increase and offset some of the negative impact of weakening expat demand. Tenants tend to come from the emerging industries, particularly in the media, IT, and medical sectors, while they maintain healthy business growth with leading companies offering housing budgets to attract and retain talents from management to junior positions. Aside from the traditional corporate clients, demand from individuals or families looking to enjoy a quality and comfortable home environment is also increasing, leading to a more diversified client base. As the range of tenants' backgrounds and tastes continue to grow so is the offering of new investors and operators who are stepping into the market with new products.

Alongside the long-stay customers, more high-end serviced apartments have entered the short-stay market, taking advantage of the recovery of domestic travel. While border controls are unlikely to be relaxed anytime soon, domestic travel has steadily recovered despite the occasional recurrences of COVID-19. Total passenger volume of domestic flights increased 5.4% in 2021 to 440.4 million. During the two key holidays in May and October, the number of tourists reached 103% and 70% of pre-COVID 2019 levels. Though the tourism sector saw an uneven recovery due to persistent local outbreaks and travel restrictions by local authorities, key cities and hot tourism destinations still managed to outperform. Landlords and operators are willing to adopt flexible terms and accept short-stays to capture a share of the growing market opportunity.

Effective epidemic control and economic recovery allowed Shanghai to record fastest rental growth of the first-tier cities given limited new supply and strong demand. Shanghai's serviced

Figure 5: Serviced apartment overall and luxury rental index in Beijing and Shanghai after COVID-19 outbreak



Source ASKCI, Savills Research

apartment rents increased 7.9% by Q3/2021. Luxury projects growth exceeded the market average by 3.9 ppts. Beijing's luxury market grew 3.9% YoY despite the overall market recording a moderate decline. High net worth individuals are more willing to spend extra for higher living standards, especially given the potential for restricted travel, WFH periods and home quarantine. Nevertheless, very few projects can provide the across the board quality from service and facilities to interior design and landscaping, leading to demand outstripping supply in the super high-end market.

Investors are increasingly interested in the entry-level serviced apartment and premium multifamily sectors which stand apart from the more competitive mass market composed of strata-title apartments and economic housing. Ascott opened lyf in Hangzhou and has plans to expand to Shanghai, Beijing, and Xi'an. Jinjiang Hotel launched Tulip LODJ positioned as a premium multifamily brand, meanwhile Funlive under SCE Property has already opened in 15 cities around China.

Diversified demand of high-end residential leasing market

Nouveau riche

The rapid growth of internet related start-ups has enriched the background of tenants in the high-end leasing market. New media practitioners, entrepreneurs and freelancers can work from anywhere making their choice of residence more varied. At the same time, the rising proportion of younger tenants is prompting operators to experiment with innovative services and personalised interior design.

New employment drivers/clusters

Beijing, Shanghai, Guangzhou, Shenzhen, and Hangzhou are the top cities for Chinese Internet enterprises to set up offices. Leading firms such as JD.com, Kuaishou (快手), Bilibili, Tencent Music Entertainment Group, and ByteDance have all bought land to develop headquarter space in these popular first and second tier cities in 2021. These firms and their employees will become an important source of demand for the residential leasing market in the future, with rising incomes supporting demand for the high-end serviced apartment market.

Wait and see home buyers

New housing supply in popular cities and mature areas remains limited, while prices remain high. Additionally, loan and purchase restrictions, higher taxes, and drawn-out sales processes have made it more challenging to find the ideal property and harder for households to get on the property ladder. Until they find the property that they want and can afford, more households are turning to the leasing market, boosting demand in the short to mid-term.

Secondee dependents

Secondees dependents have found it challenging to secure entry permits in 2020/2021, leading to an increase in demand for one-bedroom units. However, as authorities make allowances for dependents of seconded employees, the demand for larger households including two- and three-bedroom units will gradually pick up helping to boost market occupancy rates.

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